

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Electricity Market Design and Structure) Docket No. RM01-12-000

COMMENTS OF RELIANT RESOURCES, INC.

Reliant Resources, Inc. (“RRI”) welcomes the opportunity to make these comments in response to the Federal Energy Regulatory Commission's (“Commission”) Notice in this proceeding.

I.

COMMUNICATIONS

All correspondence, communications, pleadings and other documents related to this matter should be addressed to the following individuals:

Michael G. Briggs	John Meyer
Senior Counsel	Vice President-Asset Commercialization
Reliant Energy, Incorporated	Reliant Resources, Inc.
801 Pennsylvania Avenue, N.W.	1111 Louisiana
Suite 620	15th Floor
Washington, D.C. 20004-2604	Houston, Texas 77002
Telephone: (202) 783-7220	Telephone: (713) 207-6000
Facsimile: (202) 783-8127	Facsimile: (713) 207-9172

RRI requests that each of the individuals identified above be placed on the Commission’s official service list in this proceeding.

II.

INTEREST OF RRI

RRI owns and operates unregulated electric generation facilities, typically either exempt wholesale generators or qualified facilities. RRI also owns a retail electric provider that operates within the State of Texas. RRI has been an active participant in the RTO stakeholder process around the country. Both existing and future generation and

retail operations owned by RRI and its affiliates will be impacted by the decisions ultimately made by the Commission as a result of this proceeding.

III.

COMMENTS

General Comments

RRI commends the Commission and its staff for organizing an insightful and enlightening series of workshops during RTO Week. The Commission has rightly recognized that RTO development has reached a crucial juncture. Until now, the advice “take it or leave it” would accurately describe the lack of coherent direction and momentum in the voluntary RTO formation process. While it may not be necessary for the Commission to mandate all elements of RTO design, the time has come for the Commission to give clear direction to this process so that market participants can move forward with certainty to form a robust, competitive wholesale electric market. In particular, direction is required to establish standards for required market products, compatible transmission congestion management, scheduling between RTOs and settling transmission costs between RTOs. The following comments address a few of the issues raised during RTO Week.

Governance

A strong sentiment expressed during RTO Week was that the Commission should give clear direction on many issues, not the least of which is governance. Most importantly, the creation of the competitive wholesale electric market sought by both the Commission and market participants requires that the formed RTOs be of unquestioned independence. To ensure this necessary requirement, the Commission must ensure that one market segment or sector cannot dominate the decision-making process, including

the design of the market structure and congestion management principles. Transmission owners and vertically integrated utilities that wish to form Transcos are only one group of many that should have a voice in the market design. As the Commission considers how to craft its upcoming orders in each of the RTO dockets, it must ensure that all stakeholders have a place at the table and an opportunity to influence the ultimate decisions that must be made.

RRI suggests that as many as five market sectors be established (Generators, Transmission Owners/RTOs, Consumers, Marketers and Load Serving Entities) with equal standing; or put another way, one vote per sector. By mandating that a 2/3 majority be required to adopt an RTO design under this sector structure, the Commission will be assured that even though Transmission Owners file the RTO application, the application and RTO design will have broad market support. Likewise, once the RTO is approved, any change to the protocols should use the same process of stakeholder design and approval. The proponents of the proposed RTOs have announced a goal of giving a voice to all stakeholder groups in establishing and carrying out an RTO design process. Unfortunately, stated goals and achieved reality too often have failed to coincide. While RRI recognizes the large stake that transmission owners have in this process, it respectfully urges the Commission to bear in mind that transmission owners are but one set of market participants and that their views are entitled to no greater weight than the views of the other diverse stakeholders. All market participants should participate and have an equal voice in market design decisions and should have a similar voice in any protocol changes requested.

Clear direction is vital as the RTO development process moves forward. The Commission need look no further than the Midwest region, in particular the Alliance design, to be convinced that RTO development without full stakeholder involvement and clear Commission direction are unlikely to reach reasonable closure. It is virtually impossible to list all of the Comments, Answers, Motions for Stay, for Clarification or for Rehearing pending in the Midwest region, not to mention the several appeals already filed in court as a result of past Commission orders that did not go far enough. RRI respectfully suggests that the Commission continue its involvement in the RTO development process and even increase the staff's attendance at all stakeholders meetings. This presence with better direction will help create a focused approach.

Interconnection

RRI is heartened by the Commission's decision to open Docket RM02-1 (Standardization of Generator Interconnection Agreements and Procedures). RRI has long advocated a uniform approach to generator interconnection and believes that the Commission has an opportunity in Docket RM02-1 to greatly facilitate the interconnection process and remove the present uncertainty surrounding the rights of the parties to such agreements.

RRI suggests that in that proceeding, the Commission adopt a driveway/highway approach to transmission interconnection cost allocation. In other words, a generator should be required to pay the basic cost of direct interconnection (e.g., up to the breaker), referred to as the driveway. Any additional upgrades required on the transmission system (the highway) to facilitate the interconnection would be paid by the loads using the transmission system. Costs for interconnection studies should be predetermined and paid

by the generator. Transmission owners would be required to serve these potential transmission customers in a non-discriminatory manner and assure completion of transmission-related construction prior to or coincident with the completion of generation construction. The purpose of the interconnection policy must be to remove all barriers to entry and facilitate the movement of relatively lower cost power to consumers in a process that is as streamlined as possible.

RRI encourages the Commission to recognize that current Order No. 888 tariffs will need to be changed to effectively offer network service to generators. Interim arrangements whereby generators pay for network upgrades and then receive appropriate credits that they can use to pay the cost of transmission service may be required until all transmission tariffs have been overhauled and existing transmission contracts reformed.

Transmission Pricing

RRI urges the Commission to reject any arguments that it should adopt distance sensitive pricing for transmission usage. It is a basic tenet of economics that the sunk costs of the grid should not be recovered on a variable basis when the goal is to increase the efficient use of the grid. Loading individual transactions with costs other than transmission losses merely discourages transmission customers from buying new, lower cost power from generators and creates unnecessary barriers to entry for generators. While some may argue that distance sensitivity encourages generators to locate near load centers, these arguments fail to account for the difficulties in generation siting brought on by environmental regulation (e.g., non-attainment areas) and other considerations for siting generation in an economic fashion. Transmission pricing should be structured so that the fixed costs of the transmission system are recovered from those for whom the

original, incremental investment for those facilities was made, i.e. the loads on the facilities. This ensures that any load has access to lower cost power if it is available, and transactions only pay for variable costs such as losses. This approach is reasonable when the lower cost of energy created by new generator construction and operation is taken into account.

Market Monitoring

Market monitoring can provide a much-needed system of checks and balances on the market and serve to prevent market abuse, if properly structured and implemented. If designed improperly however, as has been shown in some markets, it can also be detrimental to the establishment of a transparent, robust wholesale market. In its upcoming orders, the Commission should provide that the Market Monitoring Unit ("MMU") has the authority and directive to examine the behavior of all market participants, including the RTO. The MMUs should not only look for market flaws and potential market abuse, but should also identify opportunities for improvement and should submit suggestions to the RTO stakeholder group that bears responsibility for market design and protocol changes.

To accomplish this, RRI believes that the MMU must be independent of the RTO operation. This is imperative for an RTO that has adopted a for profit Transco model. The MMU's governance could be structured and selected as follows:

1. There should be three MMU Directors.
 - The Stakeholder Committee should elect one MMU Director.
 - The RTO Board should elect one MMU Director.
 - The two MMU Directors should elect a third Director and pick a chairman between them.
2. The RTO board should fund the MMU.

3. The MMU Directors can employ a staff as required.
4. The MMU should report its findings to both the Stakeholders Committee and the RTO board.

Congestion Management

Much of the comment in the RTO workshop involved the preferred or proper congestion management scheme. The two basic methods, Nodal and Zonal, were discussed at length, with the Eastern US expressing a fairly strong preference for the Nodal (LMP) method and the Western US and Texas expressing a preference for the Zonal method. To be effective, both methods must rely on security constrained dispatch, redispatch (market-based or command limited), and some form of financial transmission (hedging) rights.

RRI believes that to minimize the large number of seams issues, each interconnected grid (Eastern, Western, ERCOT) should adopt a standard congestion management process so that compatible transmission rights and scheduling and congestion relief can be managed between RTOs. For the Eastern Grid, RRI believes LMP is probably the most accepted alternative at this time. The other interconnections need to decide on their preferred design through their stakeholder groups.

Any system adopted, including the current LMP system, needs to provide stronger incentives for building new transmission to alleviate constraints, both bulk system and local. For instance, the local PJM “offer caps” limit pricing without providing price signals that are high enough to incentivize new generation or additional transmission to remove the local supply constraint. The congestion management system adopted must

encourage new transmission line construction to eliminate disincentives such as local “offer caps.”

Other Market Issues

There are two other market-related issues requiring Commission attention as it moves forward on RTO development. RRI urges the Commission to be mindful of the need to put into place appropriate safeguards in the event that a for profit Transco model is selected by an RTO. Those safeguards must ensure that the Transco does not unfairly favor transmission solutions over generation solutions to relieve congestion. RRI fears that no safeguards will be adequate if a for profit Transco has the unfettered authority to make such decisions. In fact, the Transco Board has the fiscal responsibility to its shareholders to make decisions to increase its profits over other solutions. In order to ensure that a for profit Transco does not act in a way that improperly favors the transmission solution over possible generation solutions, an entity other than the Transco must either make such decisions or have “veto” authority over the Transco's decisions.

While much time is spent arguing whether locational marginal pricing is superior to flowgate or zonal congestion management (both of which can work), the Commission should also address the issue of the appropriate allocation of congestion rights. In many areas, incumbent transmission providers are advocating the allocation of such rights to themselves under the rubric of the protection of native load. If such rights are simply allocated to existing users so that load can only be served by existing sources, there will be no impetus to create a market for such rights and the grid cannot and will not be used efficiently. All congestion rights should be auctioned with the revenues returned to those

that paid for the transmission systems through rates, contributions for construction or some other mechanism.

IV.

CONCLUSION

RRI respectfully urges the Commission to adopt the suggestions outlined above and promptly issue the needed orders and move the process of RTO development forward. Tomorrow may be too late.

Respectfully Submitted,

Michael G. Briggs
Reliant Energy, Incorporated
Senior Counsel
801 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2602
Telephone: (202) 783-7220
Facsimile: (202) 783-8127

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